LOAN TERMS QUALIFYING FOR AND EXPENSE DEDUCTIBLE TO REDUCE CAPITAL GAINS TAX LIABILITY:

Proper documentation of the promissory note loan includes a written loan agreement between the borrower and lender outlining the terms and conditions of the loan clearly stating the purpose is to to pay off the mortgage balance of the rental property investment and that the the total borrowed amount and accumulated appropriate interest rate on the loan will be repaid when the house is sold.

The loan should be structured as an independent and arm's length transaction, meaning that it should be made on commercial terms that would be similar to a loan obtained from a financial institution. It's important to avoid any appearance of a gift or a non-genuine transaction.

Instructing the escrow to pay the money lent when the house is sold is an important step to ensure that the loan is properly accounted for and can be deducted from the capital gains. Make sure that these instructions are well-documented and provided to the escrow agent handling the sale. Repayment of the loan out of escrow funds shows that you are legally liable for the loan debt by having the loan secured by the home.

With proof of repayment, you have demonstrated a true debtor-creditor relationship the interest paid on the loan could potentially be deductible as an expense against the capital gains. clear instructions in the escrow regarding the repayment of the loan upon the sale of the house is essential. It substantiates the purpose of the loan and its repayment terms. The loan must be secured by the house: